Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

26 May 1983

China: Turning to Japan in 1983

China's intent to increase imports by 40 percent in 1983 will benefit most of its partners, but among the non-communist countries, Japan will be by far the biggest gainer. The proximity of the two countries and the compatibility of their trade--China's natural resources for Japan's technology--has created an ideal trade situation. Tokyo's willingness to provide long-term, low-interest loans and to overlook Beijing's mercurial economic policies has cemented the bilateral relationship, almost certainly winning for Japan portions of the China market that would otherwise have gone to US or West European firms. [redacted] 25X1

The Turnaround

Based on statements made by high-level officials in both countries, and on initial contract signings, we believe imports from Japan will probably rise 50-60 percent in 1983. Much of the increase will result in Japan's recapturing the market share it lost last year when China, through its readjustment program, cut overall imports by 12 percent, and those from Japan by 32 percent. The anticipated increase will mean that about one-quarter of all China's foreign purchases will come from Japan--up from 21 percent in 1982. The gains should also be sufficient to erase the $1.5 billion surplus that China registered with Japan last year--the first since the early 1960s. [redacted] 25X1

Much of the increase will come from imports of Japanese steel to rebuild aging factories and to strengthen China's infrastructure. Beijing's contracts for delivery of 3 million tons of steel in the first six months of 1983 already exceed its total purchases in 1982. By year-end, we expect steel imports from Japan to exceed 5 million tons. Machinery and equipment purchases also will show gains in 1983, although they will remain

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This memorandum was prepared by [redacted] *the China Division of the Office of East Asian Analysis. Questions and comments are welcome and may be directed to the author at telephone* [redacted] 25X1

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well below the $2 billion peak in 1981 when they accounted for more than 40 percent of total imports from Japan. 25X1

Beijing is in a strong position to increase its purchases. Consecutive record trade surpluses of $3.2 billion in 1981 and $5.6 billion last year when imports were cut dramatically, boosted China's foreign exchange reserves to more than $11 billion. Beijing has used the surplus to trim its already modest foreign debt, but is reserving substantial sums to increase imports. 25X1

Factors Behind Japan's Success

Several factors explain Japan's success in the Chinese import market. Its proximity to China generates cost advantages in shipping. In addition, natural resources that are relatively abundant in China are scarce in Japan, whereas Tokyo possesses advanced technology much-needed in China. Modern Sino-Japanese trade, moreover, dates back to the early 1960s. In 1979, the first year foreigners could establish offices in China, no fewer than 100 Japanese companies set up offices in Beijing. No other nation came close in numbers and the resultant day-to-day contacts have undoubtedly helped facilitate bilateral trade. 25X1

Although Sino-Japanese trade has had an impetus of its own, Tokyo has consistently encouraged it by seeking to minimize the deleterious fallout from mercurial Chinese economic policies. For example, Tokyo has apparently chosen to overlook the fact that Beijing backed out of its export and import commitments within a year after the two countries signed the Long Term Trade Agreement in 1978. The economic readjustment program superseded Beijing's promise to import $10 billion in whole plants from Japan over an eight-year period beginning in 1978. A leveling off of oil output in the face of rising domestic demand also untracked China's commitment to export 47 million tons of crude oil to Japan between 1978 and 1982. 25X1

In another example of Japanese forebearance, Tokyo responded to Beijing's abrupt suspension of $2.5 billion in contracts with Japanese firms in 1979 by putting together an $11.5 billion credit package for China. The package included $8 billion in commercial financing--which has gone unused--$2 billion in government-backed EXIM credits, and $1.5 billion in aid funds. Less than two years later, when Beijing canceled $1.5 billion in projects--many of the ones suspended earlier--Japan again tailored its lending program to better suit Chinese needs. The modified program included extending commodity credits that, in effect, enable Beijing to finance its domestic budget deficit with long-term, low-interest yen loans. 25X1

Despite its strong international financial position, Beijing has again approached Tokyo for aid this time requesting $5-6 billion to finance construction of 13 major infrastructure projects. Given Tokyo's financial constraints and the difficulty

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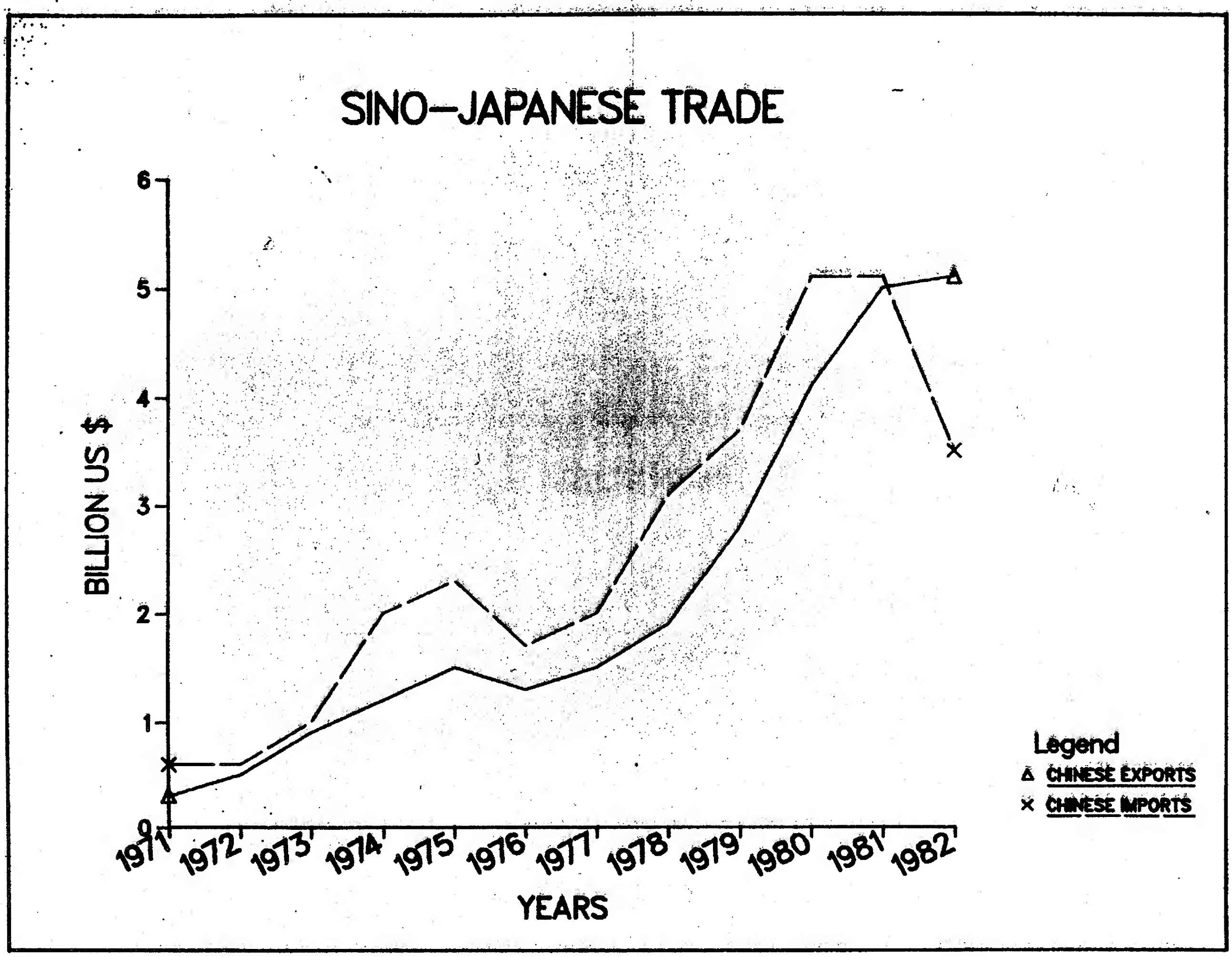
China has had in assimilating the previous $1.5 billion aid package, we think it unlikely that Japan will grant any request of this magnitude. However, with Beijing apparently poised to undertake a major import program, Tokyo may extend an additional $2-3 billion in aid, probably at interest rates of about 3 percent over 30 years. [redacted] 25X1

Most of Japan's previous credits at concessional rates have been untied, and we expect the upcoming package to be no exception. Beijing continues to insist that contracts signed under the loan agreement be subject to international bidding. Several major US companies operating in Hong Kong reported that a portion of their 1982 China business was financed by Japanese credits. Still, the funds undoubtedly give Japanese firms an advantage in contract negotiations. In many cases, Japanese companies help formulate feasibility studies that precede Tokyo's acceptance of a project for funding. As a result, the firms enter the contract negotiations familiar with the project and the Chinese personnel involved. Without the Japanese loans, Tokyo's share in total Chinese imports would probably drop. [redacted] 25X1

The availability of government-backed loans has helped Japanese businessmen maintain their share in China's import market without involvement in sometimes troublesome equity ventures. Although Beijing has strongly encouraged Western firms to participate in joint ventures--which enable China to acquire managerial skills as well as equipment, with smaller outlays of foreign exchange--Tokyo has remained as China's largest trading partner but lags behind Hong Kong and the United States as an equity investor. [redacted] 25X1

Japan's trade advantage with China could further improve if Sino-US relations continue to deteriorate. Thus far, the Chinese do not seem to have cut back on US imports for political reasons, but a major flareup of such issues as the Huguang Railway bonds or textiles quotas would likely redound to Tokyo's commercial benefit. [redacted] 25X1



SINO-JAPANESE TRADE
BILLION US $
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1971
1972
1973
1974
1975
1976
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1978
1979
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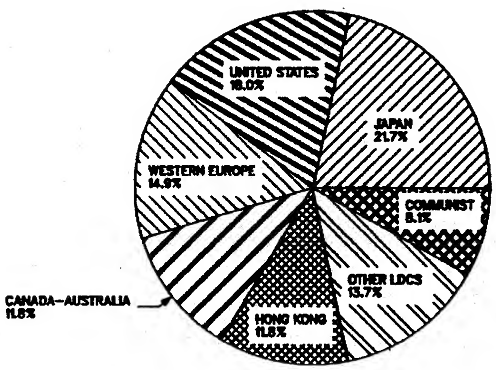
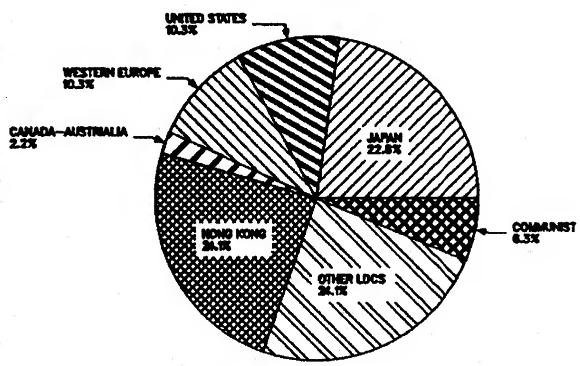
1981
1982
YEARS
Legend
CHINESE EXPORTS
CHINESE IMPORTS

CHINA: DIRECTION OF TRADE, 1982

IMPORTS



EXPORTS



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